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Research Update:

Danish Telecom Operator TDC Outlook Revised To Negative From Stable On Get Acquisition; 'BBB' Rating Affirmed

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Overview

- On Sept. 15, 2014, Danish telecom operator TDC A/S announced an agreement to acquire Norwegian cable operator Get AS for Danish krone (DKK) 12.5 billion.
- Following completion of the acquisition, which we understand could close in 2014, we expect TDC's adjusted debt-to-EBITDA ratio to increase to 3.4x (from 2.7x in 2013).
- We have revised down our assessment of TDC's financial risk profile to "significant" from "intermediate."
- We are therefore revising our outlook on TDC to negative from stable and affirming our 'BBB/A-2' ratings.
- The negative outlook reflects the possibility of a one-notch downgrade if, after peaking at 3.4x in 2014, the adjusted debt-to-EBITDA ratio does not decline to about 3x in 2016.

Rating Action

On Sept. 19, 2014, Standard & Poor's Ratings Services revised its outlook on Danish telecommunications operator TDC A/S to negative from stable. At the same time, we affirmed our 'BBB' long-term and 'A-2' short-term corporate credit ratings on the company.

Rationale

The outlook revision follows TDC's announcement on Sept. 15, 2014, that it will acquire Norwegian cable operator Get AS, a provider of high-speed broadband, pay-tv, and fixed telephony to 500,000 customers, for Danish krone (DKK) 12.5 billion (about €1.67 billion). The transaction will likely close in 2014 and lead to deterioration in TDC's credit metrics.

The rating affirmation reflects our view that after deteriorating, TDC's metrics will nevertheless sufficiently recover over the following two years to support the existing rating. It also reflects our view that TDC's business risk profile will slightly improve due to the acquisition.

We understand TDC intends to finance the acquisition primarily through unsecured bonds and, to a lesser extent, hybrid notes, which we could assess as having some equity content after reviewing their characteristics. We also understand that TDC will reduce its dividend policy from approximately 90% of equity free cash flow after special items to approximately 60% from 2015. We expect that the Standard & Poor's-adjusted debt-to-EBITDA ratio will peak at 3.4x following completion of the acquisition, but that it will gradually decline toward 3x over the next two years. We also forecast free operating cash flow (FOCF) to debt of about 10% post-acquisition. These ratios are no longer commensurate with an "intermediate" financial risk profile, according to our criteria, leading us to reassess TDC's financial risk profile as "significant."

Our assessment of TDC's business risk profile as "satisfactory" is supported by its strong position as the leading operator in Denmark's fixed-line, cable, and mobile telecom markets, good track record of maintaining solid margins through cost-cutting, and extensive and well-developed copper, cable, fiber, and mobile networks. These strengths are constrained by limited growth prospects in the mature and competitive Danish telecom market (including our anticipation of declining revenues over the next two years), as well as TDC's limited diversification and relatively small customer base. Although the inclusion of Get does not lead us to revise our business risk profile assessment on TDC upward, we acknowledge its positive implications on scale (Get will add 9% to TDC's revenues), diversification, and profitability, as we expect Get will demonstrate higher growth and margins than TDC.

Our "significant" financial risk profile assessment reflects our forecast of adjusted debt to EBITDA of 3.4x at closing of the acquisition, and our anticipation of adjusted funds from operations (FFO) to debt of 20%-25% and FOCF to debt of 10%-12%. This is partly offset by our forecast of robust FOCF generation and increasing annual discretionary cash flow (DCF) to DKK1 billion-DKK1.5 billion from 2015, following the company's revised dividend policy, compared with DKK400 million-DKK450 million in 2012 and 2013.

We assess TDC's anchor, our starting point in assigning a rating, at 'bbb-', based on our view that the company's business risk profile is at the higher end of the "satisfactory" category. Under our criteria, we have two possible anchor outcomes ('bbb-' or 'bb+') for our combination of the "satisfactory" business risk and "significant" financial risk profile assessments. We apply a one-notch positive adjustment above the anchor under our comparable rating analysis for TDC. We base this adjustment on our view of TDC's business risk profile as being at the higher end of our "satisfactory" category, strengthened with the acquisition of Get, and its financial risk profile as being at the lower end of our "significant" category, with leverage likely to decline from a peak at 3.4x. Furthermore, we expect TDC's credit ratios to be stronger than those of peers that we rate 'BBB-' and have similar business and financial risk profile assessments, including Telekom Austria (excluding any parent support) and KPN.

Under our base case, we assume:
- Modest organic revenue decline in 2014 and 2015, followed by flat to modest revenue growth in following years, and an additional 9% from the consolidation of Get.

- Improved EBITDA margin through a further reduction in operating expenditures and the inclusion of Get.
- Capital expenditures at about 15%-17% of revenues.
- Dividends declining from DKK3 billion in 2014 to DKK1.8 billion over the next few years.

Based on these assumptions, we arrive at the following credit measures:
- An adjusted EBITDA margin of 43% in 2015, after 40.5% in 2013.
- Adjusted debt to EBITDA of 3.4x at closing, declining gradually toward 3x over the next two years.
- DCF of about DKK1 billion-DKK1.5 billion per year.

Liquidity

We assess TDC's liquidity as "adequate," according to our criteria, because we expect that liquidity sources will cover uses at least by 1.2x over the next 12 months. The short-term rating is 'A-2'.

We estimate TDC's key liquidity sources at about DKK15 billion over the next 12 months, comprising:
- Consolidated cash and equivalents of DKK1.8 billion;
- An undrawn committed unsecured revolving credit facility of €500 million (about DKK3.7 billion) due February 2016;
- Two €100 million (about DKK1.5 billion) committed, unsecured bilateral facilities due December 2016 (of which about DKK1.3 billion is currently undrawn);
- A committed unsecured loan from EIB of €500 million (about DKK3.7 billion), which can be drawn until December 2015 and with a 3- to 5-year maturity; and
- Annual FFO of DKK7.5 billion.

Against these sources, we anticipate liquidity uses of about DKK7 billion during the next 12 months:
- Short-term liabilities of DKK6.1 billion;
- Annual capital spending of about DKK3.7 billion; and
- Annual dividends of about DKK3 billion in 2014 and significantly lower in 2015.

In addition, we understand that TDC has secured a DKK11.9 billion credit facility to match most of the acquisition price for Get, the remainder will be funded with cash.

Back-up facilities include a maintenance financial covenant that would be triggered only if the long-term rating were lowered below 'BBB-'. Even if this was triggered, we estimate that the covenant headroom would be about 17% in 2014, growing to 20% in 2015.

Outlook

The negative outlook reflects the possibility of a one-notch downgrade over the next 24 months if TDC's credit metrics do not strengthen as we currently expect. This could happen if operational performance was weaker than in our base case or if the company renewed any debt-financed merger and acquisition initiatives.

Downside scenario

We could lower the rating by one notch if TDC did not deleverage over the next two years so that the adjusted debt-to-EBITDA ratio remained sustainably above 3.2x or FFO to debt fell below 20%.

Upside scenario

We could revise the outlook to stable if adjusted debt to EBITDA declined to about 3x while DCF remained in the DKK1 bilion-DKK1.5 billion range.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Negative/A-2

Business risk: Satisfactory
- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Related Criteria And Research

- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013

- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
TDC A/S		
Corporate Credit Rating	BBB/Negative/A-2	BBB/Stable/A-2
Senior Unsecured	BBB	

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